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SUBJECT: KOMI: SOCIO-ECONOMIC SITUATION IMPROVING FOR
REMOTE RUSSIAN REGION

¶1. (SBU) SUMMARY. Economic progress is visible in the resource-rich Komi Republic, we found on a recent trip to that remote region. Its economy is doing well, in part because of global price gains in oil, gas, and metal, but also because of its growing paper and furniture industries and budding retail sector. Although the regional government seems to be working hard to promote small and medium-sized enterprises, corruption is a strong countervailing force. Prospects are uncertain for significantly reducing corruption, although the federal government has stepped in to address that issue. Despite such problems, we found that locals tend to be upbeat about the future. END SUMMARY.

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Background

¶2. (SBU) On a recent trip to Syktyvkar, capital of the Komi Republic, we found a prospering city in a resource-rich region. Originally a crossroads of trade and the location of dozens of Soviet gulag camps, the republic, in European Russia's northeast, has an ethnically and religiously diverse population of just over one million people. European virgin forests cover over 60 percent of the republic's territory and represent the first natural UNESCO World Heritage site in Russia. Komi's economy is based mainly on energy extraction, mining, and forestry, which together make up more than 70 percent of the republic's output. Komi is home to Europe's largest paper mill and cardboard factory; other plants produce pre-cut boards and furniture parts. To modernize and diversify its economy, Komi is seeking to develop its retail and tourism sectors) ecological and extreme sport tourism is becoming popular in its national parks, drawing a small but growing number of foreign tourists. Western-style shopping centers are appearing in Syktyvkar and Komi's other major cities. (NOTE: For more information on the geographical, sociological, political, and economic make-up of the Komi Republic, see www.rkomi.ru and www.komistat.ru. END NOTE)

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Komi's Financial Situation Positive ... For Now

¶3. (SBU) Recently appointed Regional Head Vladimir Torlopov has touted his 2006 budget as "socially oriented," but members of Komi's Public Chamber and independent media told us the budget underfunds healthcare -- one of President Putin's national projects -- and programs to fight poverty and unemployment. In Komi, 16.6 percent of the population is below the official poverty line (somewhat better than the 18.9 percent for Russia as a whole), and unemployment is 2.9 percent (versus 3.4 percent for Russia). The republic's municipalities are almost completely financially and politically dependent on subsidies from the republican authorities, our interlocutors said. Outside of the subsidies, supplemental funds to support the municipalities are distributed competitively based on detailed business

plans. Because developing such plans requires specialists and money, however, only a few of the wealthier municipalities have the resources to compete for these funds. Accordingly, the municipalities that usually receive such funds will continue to do so, increasing the divide between the municipal haves and have-nots.

¶4. (SBU) Although it is a net contributor to the federal government, Komi is on course to run an anticipated regional budget deficit in 2006 of 1.5 billion rubles (USD 53.6 million). The republic's overall debts are nearly as large as its annual budget, and further increases in debt without serious sources of new income could lead to financial problems. Despite the spending pressures, high dependency on the primary sector, and resulting vulnerability to commodity price fluctuations, Fitch Ratings changed Komi's outlook from stable to positive in 2005 and affirmed its international long-term and short-term foreign currency ratings at B and B, respectively. Likewise, Moody's Investors Service raised Komi's domestic and international borrowing ratings from B1 to Ba3, with a stable prognosis.

¶5. (SBU) After a seven-fold rise from 1998 to 2004, investment dropped in 2004-2005 to approximately 20 billion rubles (USD 714 million). The largest investment inflows took place from 2001 to 2004, up to 90 percent of which came from Austria in connection with the investment programs of Mondi Business Paper, which dominates harvesting and processing in the forestry sector. Aside from Mondi the bulk of investment in Komi's industry comes from Severstal, which is modernizing Vorkuta's coal mines, and SUAL, which continues to invest in the development of local bauxite mines and processing. The other major corporate investor, LUKoil, is moving much of its refining activity from the city of

MOSCOW 00004353 002 OF 003

Ukhta to the neighboring Nenets Autonomous Okrug, because it is more profitable to process oil there.

SME Sector Growing But Bureaucracy Is a Problem

¶6. (SBU) Regional Head Torlopov has spoken out frequently in support of developing SMEs to diversify the republic's economy. Most SMEs in Komi are retail shops, creating jobs and improving the selection of Western-style goods and services. Almost 90 percent of small businesses are located in Komi's major cities, and fifty-three percent of them are in Syktyvkar alone. From 2000 to 2005 the number of small businesses increased by one-and-a-half times: from 2700 to ¶4500. On average, a small business employs 13 people. The median salary for one worker is 8,400 rubles per month (USD 300), which is one-third less than in large and medium-sized businesses. Small businesses wield considerable influence on the republic's socio-economic development, generating almost 80 percent of the turnover of retail trade, 25 percent of consumer services, and almost 50 percent of construction work. In 2005 revenues from small businesses increased 38 percent over 2004, and investment in small business increased 1.8 times. More than half of the investment (55 percent) was in Syktyvkar, and 48 percent of that was in construction.

¶7. (SBU) The republic administration has sought to help SMEs. It worked with the Komi Chamber of Commerce, for instance, to turn an abandoned factory into a business incubator for 38 up-and-coming businesses at a time. Beneficiaries receive reduced rent, training, and commercial information. SMEs also pay regional taxes at more favorable rates than larger companies. However, SME entrepreneurs complain about the administrative hurdles they must overcome to be able to start, conduct, or grow their business. Chamber of Commerce officials told us, for example, that the Syktyvkar government mandated that all businesses replace the aging concrete sidewalks in front of their buildings with brick. The brick had to be purchased from a certain supplier so it would be uniform, and there was a citywide deadline established for

all walks to be finished. The sidewalks would remain the property of the city after the upgrade, but the building owners had to pay all of the costs associated with the installation and upkeep. Businessmen were further outraged when they found out that over eighty separate administrative approvals (both at the city and regional levels) were required to make the change. Our interlocutors said that pursuing these approvals took the average businessman an entire workweek.

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And Corruption Remains a Problem

¶18. (SBU) Such excessive bureaucratic hurdles are often rife with corruption opportunities. There are no regional or city programs to combat corruption, although in March a parliamentary roundtable recommended creation of a regional Anti-Corruption Commission. In 2005, about 4,500 officially recorded economic crimes -- worth about 165 million rubles (USD 5.9 million) -- were committed in Komi. According to komistat.ru, the number of economic crimes in the republic grew 16 percent in 2005 and is up 30 percent since 2000. Komi entrepreneurs told us that almost all SMEs enjoy the protection ("krysha" or "roof") of bureaucrats and law enforcement agencies, and that this is essential to commercial success. Local authorities have been reluctant to attack the problem because they would essentially be giving up a key source of income.

¶19. (SBU) Additionally, entrepreneurs say they are expected to sign "contracts" with government entities to cover the "costs" of fire, health, sanitary, and security inspections. Normally, these inspections would happen once every two years, with the costs covered by the budget. In Komi, however, businesses pay for these "contracts" when they first register and then are told to expect "inspections" every month or so, paying a "fee" each time. As long as the contract is current, the business will likely pass the inspection, but the business's profit margins are squeezed because they are paying both legitimate taxes and these "contract fees."

¶10. (SBU) Arson appears to be a favored mode of intimidation or retribution in the republic. Ukhta authorities are prosecuting a case against an organized crime group that extorted a significant sum from businessmen to support imprisoned colleagues. The criminals not only threatened the businessmen but even burned one of their cars to intimidate them. Stores have been set on fire in Usinsk, apparently because their owners refused or were late in paying

MOSCOW 00004353 003 OF 003

extortionists. In the most extreme case of arson, in July 2005, a fire in a shopping center killed 25 people in Ukhta because no one could escape through the metal grills on the windows.

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Federal Government Gets Involved

¶11. (SBU) Federal authorities appear to be growing tired of waiting for local officials to adopt decisive anti-corruption measures and remove barriers for SME development. After Russia's General Procurator issued an August 2005 order requiring regional procurators to provide more oversight in implementing laws defending SME rights, the Komi procurator created a working group to execute that order. Reporting on the group's first month of operation, a procuracy official said that investigators found evidence that criminal groups, government officials, and policemen were extracting bribes from businesses. Procurators have filed several criminal cases as a result. For example, an official in Ukhta faces charges for soliciting a USD 25,000 bribe from an entrepreneur seeking to rent municipal property, and a Komi Interior Ministry investigator and a former tax police official face charges for seeking bribes in return for

stopping an investigation against several businessmen. In April, the Komi Prosecutor's Office opened a criminal case against a deputy industry and energy minister for taking a USD 1.8 million bribe from a company director and town council deputy in Troitsko-Pechorsk in exchange for assistance in the wood-processing business. Charges without convictions tend to be commonplace in Komi, however, and this new initiative appears to be no exception. Indeed, Syktyvkar Deputy Mayor Vladimir Pystin was charged with embezzling over three million rubles (USD 107,000) in computer equipment meant for regional schools, but managed to evade conviction by returning the embezzled money to the regional government.

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COMMENT

¶12. (SBU) Given its solid industrial base and relatively well-developed infrastructure, the Komi Republic seems to have good economic prospects. Syktyvkar has a strong entrepreneurial feel to it, with housing and commercial construction booming and foreign-made cars crowding the streets. Customer service approaches Western standards in the main hotel and restaurants. With an improved tourism infrastructure and better marketing, Syktyvkar and the republic in general could capitalize on their many cultural and natural attractions. Lack of economic diversification, budget woes, and corruption remain nagging problems that even federal intervention will be hard-pressed to eliminate. Nonetheless, our visit suggested that the typical Komi citizen's attitude is upbeat and positive about the future.

BURNS